

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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PLR-114296-10

Date: August 19, 2010

City:

Trust:

State:

Dear :

This letter responds to a letter from your authorized representative dated February 12, 2010, as well as subsequent correspondence, submitted on behalf of the City, requesting rulings that the Trust's income is excludable from gross income under § 115 of the Internal Revenue Code (Issue 1) and that the Trust is not required to file an annual income tax return (Issue 2).

On December 8, 2009, the Internal Revenue Service issued a favorable private letter ruling to the City under § 115 of the Code (PLR 201013026) regarding a trust established by the City to fund post-employment health insurance for eligible retirees. Under the health benefit plan funded by this trust, a retiree may elect to continue his coverage under the City's group health insurance plan or to purchase coverage from another insurance carrier. The trust which was the subject of the December ruling reimburses a retiree for his health care expenses according to a formula based on years of service. The specific facts and representations submitted by the City with respect to the December ruling are incorporated by reference. With respect to the current ruling, the City represents the following facts.

## FACTS

The Trust was established by the City to fund an implicit rate subsidy. The purpose of the Trust is to allow retired City employees who elect to continue their health care coverage under the City's group health insurance policy to pay the same premiums as are charged for current employee coverage.

The board of trustees (the board) is responsible for the administration and management of the Trust, including investment of trust assets. The board is composed of the treasurer, the finance director, and a council member of the City, as well as two residents of the City appointed by, and serving at the pleasure of, the city council. The trust instrument may be amended at any time by an ordinance adopted by the city council, upon recommendation of the board. The City represents that the Trust provision allowing for retroactive amendments will be deleted.

Under the terms of the trust instrument, only the City may make contributions to the Trust; the board holds all fiduciary powers necessary to carry out the purposes of the Trust, including investment, management, and control of trust assets; trust assets are used to make periodic payments to the City for reimbursement of its retiree implicit rate subsidy, the amount of which is actuarially determined according to the Governmental Accounting Standards Board (GASB); and the income and earnings of the Trust are used to pay trust expenses and fees and offset future contributions by the City.

Before trust termination, and except for trust administrative expenses, trust assets may not be used or diverted for any purpose other than to fund the retiree health insurance subsidy for the exclusive benefit of the City and its retirees. The board may terminate the Trust at any time by executing a written instrument. Upon termination, and after satisfaction of all trust liabilities, any remaining assets shall be returned to the City. In no event may trust assets be distributed to an entity that is not a state, a political subdivision of a state, or an entity, the income of which is excluded from gross income under § 115.

## LAW AND ANALYSIS

### ISSUE 1

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from

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gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) was excludable from gross income under § 115. In Rev. Rul. 90-74, private interests neither materially participated in the organization nor benefited more than incidentally from the organization.

The Trust was established and is maintained by the City to provide a special rate subsidy that allows retired employees to obtain health insurance under the City's group policy at the same premium rates as are charged to cover active employees. Providing such a benefit to former public employees constitutes the performance of an essential governmental function within the meaning of § 115(1). See Rev. Rul. 90-74 and Rev. Rul. 77-261.

The provision of health insurance to its retired employees satisfies the obligation of the City under its retiree health benefit plan to provide that benefit; thus, the income of the Trust accrues to the benefit of the City, which is a political subdivision of the State. No private interests participate in, or benefit from, the operation of the Trust, other than as providers of goods and services. Any amounts remaining in the Trust after the satisfaction of all Trust liabilities, including reasonable fees and expenses, shall be returned to the City. The benefit to retired City employees is incidental to the public benefit. See Rev. Rul. 90-74.

#### LAW & ANALYSIS ISSUE 2

Section 301.7701-1(b) of the Procedure and Administration regulations provides, in part, that the classification of organizations that are recognized as separate entities is determined under §§ 301.7701-2 through -4, unless a provision of the Code provides for special treatment of that organization.

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Section 301.7701-4(a) of the regulations provides, in general, that an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

The City contributes money to the Trust to fund its retiree implicit rate subsidy. The board is charged with protecting and conserving trust assets for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of a business for profit. If the Trust is recognized as a separate entity under § 301.7701-1, then it will be treated as an ordinary trust under § 301.7701-4(a).

Section 6012(a)(4) provides that every trust having taxable income for the tax year, or having gross income of \$600 or more for that year regardless of the amount of taxable income, must file a return with respect to income taxes under subtitle A.

#### CONCLUSION

Based solely on the facts and representations submitted by the City, and as of the date the proposed amendment to the Trust agreement is adopted:

1. We conclude that the income of the Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Consequently, we rule that the Trust's income is excludable from gross income under § 115(1).
2. Assuming that it is a separate entity under § 301.7701-1, we conclude that the Trust is classified as an ordinary trust under § 301.7701-4(a). Section 6012(a)(4) does not require a trust without taxable income to make a return of income when gross income is less than \$600. Because the Trust's income is excludable from gross income under § 115(1), we rule that the Trust is not required by § 6012(a)(4) to file an annual income tax return.

Except for the specific rulings above, no opinion is expressed or implied regarding the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no representation is made that contributions or premiums paid on behalf of, or benefits received by, employees, former employees, retirees, spouses, dependents, or others will be tax-free. This ruling concerns only the federal tax treatment of the Trust's income and may not be cited or relied upon as to any matter relating to the taxation of accident or health contributions or benefits.

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Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

SYLVIA HUNT  
Assistant Chief  
Exempt Organizations Branch 2  
Office of Division Counsel /  
Associate Chief Counsel  
(Tax Exempt & Government Entities)

enclosures: copy for § 6110 purposes